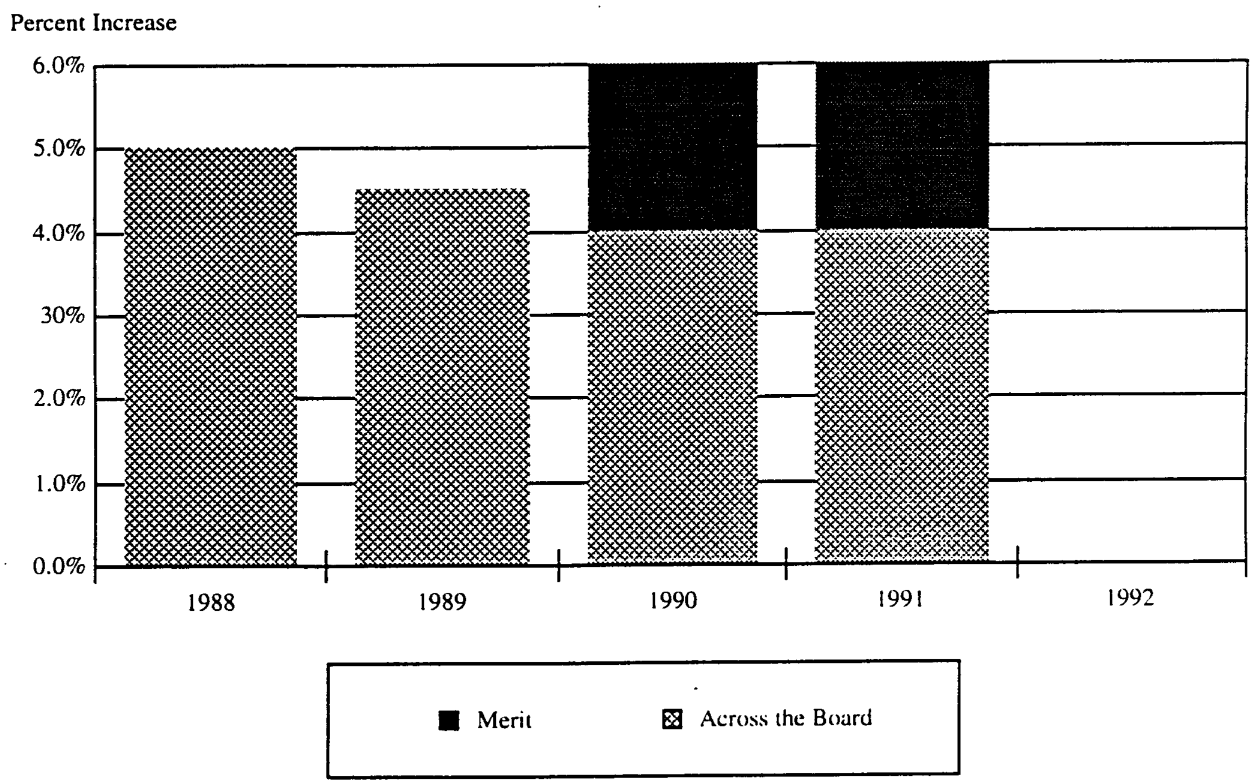
Exhibit 3-14
Dual Career Tracks

Band	Managerial	Technical
11	Executive Director	
10	Director	Senior Technical Administrator
9	Senior Mgr.	Technical Administrator
8	Manager	Senior Advisor
7	Supervisor	Advisor
6		Senior Specialist
5		Specialist
4		Senior Technician
3		Senior Administrative Support, Technician

Exhibit 3-15
North Carolina Legislated Salary Increases



Source: Fiscal Research Division of the North Carolina General Assembly's report - Overview: Fiscal and Budgetary Actions

Date: 1991 Session

In North Carolina, the fiscal year 1991 average performance increase awarded to State employees was 2.61 percent, which is below the comparative norms for other state governments. According to the 1990-1992 North Carolina Compensation Report, prepared by the Office of State Personnel, the average performance increase for the private sector in 1991 was 4.97 percent. The projected 1992 performance increase for the private sector is 4.5 percent.

Although it may appear that the State's salary increases are below those of other state governments, this is not the case. Exhibit 3-16 shows that the State remained competitive with the market in total salary increases (i.e., cost-of-living plus average performance increases). The salary increases for North Carolina shown in Exhibit 3-16 do not include longevity pay.

An annual survey conducted by the American Compensation Association shows that since 1989:

- Organizations have begun to move away from cost-of-living increases. Exhibit 3-17 reflects this shift for education, government, hospital and health care, and the aggregate of all industries for the United States.

- In 1989, 32 percent of the organizations participating in the survey awarded cost-of-living/general increases.

- In 1992, only 5 percent of the organizations awarded cost-of-living/general increases.

According to a survey by the National Association of State Personnel Executives, 50 percent of the states have longevity programs, demonstrating that longevity pay in the public sector continues to be a popular way to reward state employees. The State of North Carolina currently spends approximately $30 million a year on longevity for State employees in all three branches.

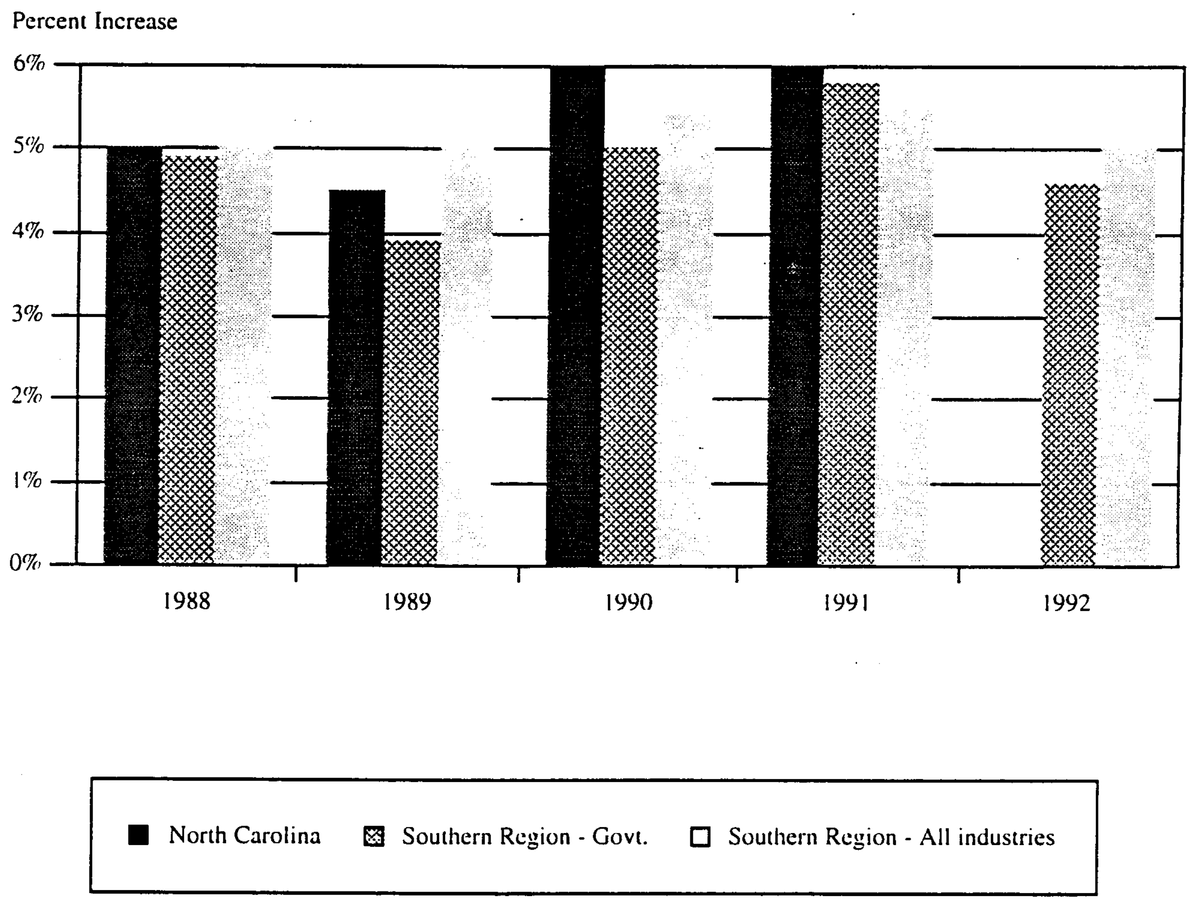
We also analyzed the prevalence of longevity programs in the private sector by reviewing the 1990-1991 North Carolina Compensation Report.

- Only 8 percent of the 76 companies provide longevity pay to their employees.

- Of the state and local government survey participants, 74 percent (26 of 35) provide longevity pay.

We can conclude that longevity pay is a popular means of rewarding employees in the public sector but is not a prevalent practice in the private sector. The argument will arise that longevity is needed to maintain competitive compensation levels. Salary levels should be evaluated to determine their competitiveness, and positions that are low should be brought in line with the market. This evaluation is part of the classification study

Exhibit 3-16
Salary Increase Comparison



Source: American Compensation Association (ACA) Salary Budget Survey and Fiscal Research Division (FRD) of the North Carolina General Assembly's report - Overview: Fiscal and Budget Actions

Date: ACA - 1992-93 report
FRD - 1991 Session

Exhibit 3-17
Percent of U.S. Organizations Granting Cost-of-living/ General Increases and Performance/Merit Increases

INDUSTRY	COST-OF-LIVING/GENERAL INCREASES 1989	1990	1991	1992*
Education	41%	41%	29%	24%
Government	82%	75%	55%	50%
Hospital and Health Care	20%	21%	18%	18%
All Industries	32%	30%	6%	5%

INDUSTRY	PERFORMANCE/MERIT INCREASES 1989	1990	1991	1992*
Education	81%	66%	95%	88%
Government	78%	73%	78%	90%
Hospital and Health Care	81%	78%	97%	98%
All Industries	84%	80%	95%	99%

*Projected

Source: American Compensation Association Salary Budget Survey
Date: 1992-93 Report

recommended in Finding 6.

To move away from longevity pay, the following are two of the major options available for the State:

Option 1: Eliminate the longevity program altogether.

Dollars available for performance pay: $30,000,000

Option 2: Phase out the program.

Provisions

- The legislative and judicial schedules should be made equitable with the executive branch's schedule (see Finding 2)
- New hires will receive no longevity pay
- Employees not currently receiving longevity pay will not be eligible for longevity pay
- Freeze the actual longevity payment for those currently receiving longevity at its current annual sum and allow attrition to eliminate the program

Dollars available for performance pay: $4,125,000

Assumptions

- Approximately 2,500 employees with more than 10 years of experience will leave the State in fiscal year 1993
- Average salary of the State employee is $25,000
- Average longevity payment is 3 percent

Recommendation

For the State to use its compensation funds more effectively, longevity pay should be eliminated and the funds reapportioned to other salary funds such as performance increases. If the State decides to continue the longevity program, we recommend that the judicial and General Assembly longevity schedules be made equal to the executive branch classified schedule. This recommendation is discussed further in Finding 2.

The administration of pay-for-performance includes three steps:

1) Analyzing merit or salary increase budget data and information from published surveys. In determining a merit pay budget, cost-of-living is incorporated into the merit increase guideline percentages

2) Adjusting the pay structure in line with compensation philosophy, the market, and the approved salary increase budget for the year

3) Moving employees in the pay grade relative to such factors as level of performance and location in the pay grade

To move employees through a grade based on performance and location in the grade, the State should consider using merit increase guideline charts. Guideline charts identify the employee's current performance rating and location in the pay grade. An illustrative guideline chart is shown in Exhibit 3-18. The intersection of the dimensions, rating, and pay location identify a pay increase percentage.

The rationale for granting different increase percentages to employees receiving identical performance ratings is that those in the upper quartile are already receiving more pay and this permits those in the lower levels of the pay range to improve their situation relative to the salary grade midpoint. This provides the opportunity to slow the movement of an overpaid employee or the poor performer. It also allows for a more rapid increase for the employee in the lower portion of the grade who is performing well.

During the 1991-1992 General Assembly session, legislation was introduced to restructure compensation for employees subject to the State Personnel Act. The package was sponsored by the State Employees Association of North Carolina. It is said to provide a process by which State employees can receive annual salary increases based on their experience, economic factors, performance, and years of service. Exhibit 3-19 presents a summary of the proposed package components and the differences between it and the performance audit recommendations.

Finding 8 - Eighty-three percent of fiscal year 1991's eligible employees who underwent evaluation were rated "exceeds expectations," which is so highly skewed that it reduces the performance evaluation's effectiveness for use in a reward for performance system

Our analysis indicates that the effectiveness of the performance management system to adequately reward performance is suspect.

An analysis of 1991 performance ratings found that 83 percent of classified employees who underwent evaluation received a rating of "exceeds expectations" which is equivalent to a 4 or 5 rating of the new system. We do not have a breakout by rating level because the five-level rating is not effective until fiscal year 1992 so all employee data was input in the data

Exhibit 3-18
Illustrative Merit Increase Guideline Chart

Note: This guideline chart incorporates cost-of-living increases and merit increases. This is not a recommendation; it is illustrative.

Performance Level	Position in range before increases					
	Below Minimum	First Quartile or Below	Second Quartile	Third Quartile	Fourth Quartile	Above Maximum
5 Outstanding Performance	12%	10%	8%	6%	4%	Flat Perf. Bonus
4 Very Good Performance	10%	8%	6%	4%	2%	0%
3 Good Performance	8%	6%	4%	2%	0%	0%
2 Below Good Performance	No Increase	No Increase	No Increase	No Increase	No Increase	No Increase
1 Unsatisfactory Performance	No Increase	No Increase	No Increase	No Increase	No Increase	No Increase

EXHIBIT 3-19
COMPARISON OF SEANC PROPOSED PACKAGE AND AUDIT RECOMMENDATIONS

Package	SEANC	Audit Recommendation
Component I Salary Schedule Two elements: 1) Career growth recognition 2) Cost-of-living adjustment (COLA)	1) Career Growth Recognition - Systematic increases for satisfactory performance - Increases based on current salary in relation to midpoint - Increase is a percent of midpoint	1) Merit Increase Guideline Chart - Annual salary increases based on performance level and position in salary range (see Exhibit 3-18) - Annual salary increase incorporates cost-of-living and merit - Increase is a percent of employee's actual salary
	2) COLA - Increase in salary schedule and employees' salaries based on economic indices	2) Salary Structure Adjustment - Increase in salary structure based on economic indices and labor market movement
Component II Performance bonus	Lump sum bonus payment to employees whose performance is outstanding (performance level 5)	Lump sum bonus payment to employees whose salaries are above maximum of salary range and whose performance is outstanding (performance level 5)
Component III Longevity pay	Annual bonus payments to State employees with 10 or more years of creditable service	Eliminate longevity pay

base as either "meets expectations" (equivalent to a 3) or "exceeds expectations." Only 15.4 percent received a rating of "meets expectations" and only one percent did not meet expectations. It is unlikely that such a large number of employees are really performing at "exceeds" levels. This is a highly skewed set of ratings. It indicates that managers and supervisors are using the system improperly by giving higher ratings in order to grant salary increases. The fact that employees do not receive performance increases for satisfactory performance puts pressure on managers in evaluating performance and communicating to employees that meeting job expectations is not good enough for a performance increase.

In addition, from a legal standpoint, having such a "skewing" can impact the State's ability to terminate employees as circumstances dictate. This is the largest area of litigation in the workplace today.

According to G.S. 126 2(c)(2), the following rating scale was effective July 1, 1991, for departments, agencies, and institutions. Only rating levels 4 and 5 are eligible for performance increases.

5 -Outstanding Performance
4 -Very Good Performance
3 -Good Performance
2 -Below Good Performance
1 -Unsatisfactory Performance

Departments, agencies, and institutions may receive permission from the State Personnel Commission to have more than 5 levels with the top two levels qualifying as "exceeds." The five level rating system was established to provide consistency in the performance management process throughout the State.

We have reviewed the new performance management system developed by the OSP and have determined that the system is functionally sound. The State's approach to performance management links actual job responsibilities and management's expectations with the performance evaluation process. The system requires managers to develop a work plan to discuss with employees about what is to be accomplished in a 12-month work cycle. The performance management system also has a new format this year whereby actual performance results are documented during the performance review and the performance results rated.

The high level of criticism of the performance management system among State employees and managers (noted in our findings from the employee survey) can be attributed, in part, to the situation that no merit funds were appropriated for fiscal year 1992, and the availability of future funding is unclear. Employees appear to believe that the performance management system is not worthwhile if there is no merit funding. Supervisors have a high level of criticism for the same reason. In addition, the performance management system takes considerable time to complete, document, and communicate, which is further complicated by the frustrations of dealing with dissatisfied employees.

The performance management system should be used as a tool for managers to effectively manage their employees; it should not be viewed as merely a means for determining performance increases.

Recommendations

- For the State to reward employees more appropriately for their performance, it should allow performance increases to be awarded for satisfactory performance. If employees are performing at expectations (level 3), they should be rewarded for their satisfactory performance, although their performance increase should be less than those that are rated at a level 4 or 5. This will help alleviate the problem of skewed results and will send a clear signal of change in the compensation philosophy of the State toward pay for performance as opposed to focusing on cost-of-living or longevity pay. This recommendation reinforces the recommendation for Finding 6 related to merit increase guideline charts.

- Continue to monitor and report performance increases by EEO protected class categories to ensure that the performance pay is not used in a discriminatory manner. This should be done in conjunction with monitoring hiring, promotions, demotions and separations for protected classes.

- The State's performance management system, if administered correctly, can provide management with an effective tool to manage and communicate with employees. Performance evaluation/measurement training sessions for evaluations should be increased. The OSP currently has one position dedicated to training managers and personnel specialists on the system. There are also trainers in most of the large agencies who train managers on their specific performance management format. More resources need to be made available to train managers and communicate to employees the benefits of performance management. A staffing analysis should be conducted to determine how many trainers in OSP are needed to improve the current training schedule.

Employee benefits

The State's employee benefits programs are not cost-effective. The individual findings that support this conclusion are:

- The State spends approximately $30 million more than other employers in North Carolina for hospital admissions, outpatient visits, surgical procedures, and office visits.

- The State has a limited program to prevent catastrophic illness, which is not structured to achieve substantial cost savings.

- Employees and retirees are dropping dependent coverage under the indemnity plan, which threatens the viability of the medical plan.

- The current contribution rates circumvent the intent of the law.

- The State's benefits program lacks a comprehensive design that allows it to be tailored to employees' needs.

- The administration of the employee pension program is fragmented.

These findings and our recommendations are discussed in detail below.

Finding 9 - The State spends an additional $30 million for health care costs over what other employers are paying for equivalent services

Health care costs paid by the State are consistently higher than those paid by other employers in North Carolina that have been able to negotiate lower costs with medical providers. Our analysis examined data provided by the plan administrator and the Fiscal Research Division and compared it to statistics compiled by Mutual of Omaha, which semiannually compiles statistics on medical care costs by state.

Mutual of Omaha was chosen as the comparison source for several reasons including:

- The publication is readily available and has been published for many years, which allows for general comparisons with the State over many years

- Mutual of Omaha provides an outside source that is not tied to the State plan for comparison

- The data for North Carolina is reasonable when compared with other sources such as the **Health Statistics**, published by the American Hospital Association

- Mutual of Omaha's data for North Carolina covers 31,500 employees, which conservatively represents 63,000 lives, according to Daniel J. Claussen who is responsible for producing **Current Trends**

It is important to note that there are differences and similarities between the State's program and employers in the Mutual of Omaha data.

Some employers with Mutual of Omaha are small and initially must provide evidence of insurability for their employees. The State plan has a strict preexisting limitation of one year for late entrants that prevents the plan from paying for an illness for which a late entrant received medical care prior to becoming insured under the plan.

Mutual of Omaha operates a Preferred Provider Organization (PPO) in Charlotte. Blue Cross/Blue Shield (BCBS) negotiates discounts with several providers throughout the State. Thus, we based our analysis on the comparison of charges submitted by providers. By basing the comparison on charges, the impact of discounts and benefit levels is mitigated.

One of the differences between the State and the Mutual of Omaha data is the rates of incidence for hospital admissions. This difference is shown below:

Admissions per thousand

Year	Mutual of Omaha	State
1991	61.7	72.0
1990	63.9	72.7
1989	56.0	73.1
1988	60.2	77.4

Using the rates of incidence shown in the Mutual of Omaha data from 1988 through 1991, the State incurred costs on average 30 percent higher than those employers covered by Mutual of Omaha. Using the State's rates of incidence, the incurred costs were on average 10 percent higher. In our cost analysis we have utilized a 10 percent differential. We also believe that the plan administrator has taken the first steps in addressing this issue through the implementation of hospital discounts.

Exhibits 3-20, 3-21, 3-22, and 3-23 compare State expenditures to expenditures for employers administered by Mutual of Omaha.

- The State is consistently paying more per hospital admission than private employers, as shown in Exhibit 3-20. In 1991, the differential between the Mutual of Omaha average cost in North Carolina and the State's cost was approximately 10 percent, which equates to $15,285,000 in additional expenses to the State.

- The State paid an additional expense of $3,873,000 for outpatient visits in 1991 when compared to private employers, as shown in Exhibit 3-21.

- The State paid $8,907,000 more than private employers for outpatient surgery in 1991, as shown in Exhibit 3-22.

- When compared to other employers, office visits cost the State an additional $2,259,000 in 1991, as shown in Exhibit 3-23.

Cumulatively, this represents expenditures of approximately $30 million in excess of what other employers are paying for similar services.